IN THE

Supreme Court of the United States

OCTOBER TERM, 1949.

No. .

Morris Eisenberg, Petitioner and Appellant below,

v.

Commissioner of Internal Revenue, Respondent and Appellee below,

---

No. .

Herman Schaeffer, Petitioner and Appellant below,

v.

Commissioner of Internal Revenue, Respondent and Appellee below.

Petition for Writs of Certiorari to the United States Court of Appeals for the Third Circuit and Brief in Support Thereof.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Your petitioners respectfully show:

Summary Statement of the Matter Involved.

This case involves taxability of certain income to petitioners either under the family partnership doctrine, or as grantors of trusts to which petitioners conveyed partnership interests.

The material facts may be summarized as follows:

About **ten years before the creation of this family partnership,** and about **five years before the petitioners organized** Bailey's Furniture Store, **the business out of which the family partnership grew,** each of the petitioners had opened savings bank accounts for his children. Each account was designated with the name of one of the petitioners as trustee for one of his children (R. 6). All of the children were then minors. (The oldest became of age in 1942.) The petitioners' names were added to the accounts at the instance of the bank officials (R. 18).

When Bailey's was first organized about one-half of the capital was obtained from the children's bank accounts. Each of the petitioners borrowed about $25,000.00 from his children's accounts in order to obtain capital to start the business. The business was first organized as a partnership consisting of the two petitioners, and there was no record made on the firm's books at that time of the children's interest in these funds (R. 6, 7, 17, 19, 60).

Bailey's Furniture Store was engaged in the retail furniture business, with practically all of its sales made on an installment basis (R. 10). The retail furniture installment business requires a substantial volume of continuously available capital (R. 17, 18). After a few years had elapsed, when petitioners wished to repay the children, they found themselves unable to do so without seriously handicapping their business (R. 35, 64). They then gave consideration to setting the children up as creditors on the books of Bailey's Furniture Store. This idea was rejected because of the effect such a move would have had on the firm's credit rating (R. 20). It was then determined that the children's interests in the business should

be given recognition by making them partners. Pursuant to that decision the following steps were undertaken:

On December 30, 1939, petitioners executed their first written partnership agreement. The agreement was to run for one year, with automatic renewal from year to year in the absence of notice. Each of the petitioners was to receive a salary of $7800.00 for the year (R. 6, 7). On January 2, 1940, each of the petitioners executed several trust indentures, one for the benefit of each of his children, giving to himself, as trustee, various percentage interests in Bailey's aggregating one-half of his interest therein. On January 3, 1940, the petitioners, as individuals and as trustees, executed an Addenda to the partnership agreement making the trusts partners in Bailey's. The firm's bank was notified, and a fictitious names certificate showing the children's interests was filed with the Commonwealth of Pennsylvania (R. 7, 8, 9).

A capital account for each child's trust was set up on the books of Bailey's at the beginning of 1940, and the petitioners' accounts were charged accordingly. Beginning in 1940 and through the taxable years here involved, each child's account has been credited with its proportionate share of the annual income remaining after deduction of petitioners' salaries. The petitioners each received an annual salary of $7500.00 to $10,000.00. No portion of the partnership income credited to the children has been used to defray household expenses or expenses of the children (R. 10).

In 1942, as a result of adversary proceedings brought in the Philadelphia Common Pleas Court by one of the trust beneficiaries, and in which all of the trust beneficiaries and both of the petitioners were named as parties, the 1940 trust agreements were reformed and petitioners were removed as trustees. The decree became final on May 19, 1943. By its terms the new trust agreements were made effective as of January 2, 1940. In each new agreement the wife of petitioner and another person were

named as the new trustees (R. 10, 11). In addition, the revised agreements made the following important changes:

The trustees were given the power to withdraw the trust funds from the business. The trustees were granted the right to inspect the partnership's books and records and to have periodic financial reports. The trustees could require such detail in the reports and such additional information as they considered desirable, and on trustees' demand they were to receive the trusts' share of partnership profits from time to time (R. 12, 48, 49).

The trustees were forbidden to pay any part of principal or income to the grantors or to use any of it for grantors' benefit. The trustees were prohibited from distributing principal during the term of the trust or use any of the trust income during the beneficiaries' minority (R. 11, 12)

Despite the above facts, most of which appear in their Findings, the Tax Court made the following ultimate finding:

> "No completed gifts of independent property were ever made either to the children of Schaeffer or Eisenberg, respectively, nor to the trusts created in their behalf and none of them were valid partners in the Bailey's Furniture Co. for federal income tax purposes" (R. 12).

In prior proceedings, involving the tax years 1940 and 1941, it was determined (Eisenberg and Schaeffer *et al v.* Commissioner, 5 T. C. 856, affirmed 161 F (2d) 506 (CCA 3rd), Cert. Den'd. 332 U. S. 767), that petitioners were taxable on the income of the trusts under the doctrine of Helvering *v.* Clifford, 309 U. S. 331. In those proceedings no determination was made on the family partnership issue. The revised trust agreements were not considered to be effective with respect to those years, nor were the so-called Clifford regulations (Reg. III, Sec. 29.22(a)-21) considered in that litigation.

With respect to the tax years now under consideration (1942-1944), the Commissioner has argued two grounds for taxing the entire business income to the petitioners, *i. e.*—that the children's partnership interests are not entitled to tax recognition, and—that under the Clifford doctrine the income of the trusts is taxable to petitioners as grantors thereof. The Tax Court accepted the Commissioner's view on the family partnership question, and found it unnecessary to go into the question of petitioners' taxability as grantors (R. 13). Its opinion recites that the interests of the children are not recognizable in the absence of capital originating with them or services contributed by them (R. 14).

The Circuit Court entered judgment affirming the decision of the Tax Court on May 9, 1949 (R. 73, 74), upon the Findings and for the reasons stated in the Tax Court opinion, without any further discussion (R. 72). On May 26, 1949, on motion of petitioners, the time for filing application for rehearing was extended by the Circuit Court (R. 77). Within the time so extended petitioners filed their Petition for Rehearing (R. 78). On August 16, 1949, the Circuit Court denied the petition for Rehearing and its judgment thereupon became final (R. 82).

Jurisdiction

The jurisdiction of this court is invoked under 28 U. S. C. 1254.

Questions Presented.

1. Did not the petitioners intend to create a bona fide partnership?

2. Are not the partnership interests of the trusts established by petitioners for their children recognizable for tax purposes?

3. Are the petitioners taxable on the income of the trusts as grantors thereof?

Reasons Relied on for Allowance of Writ.

1. The decision of the Circuit Court affirming, and in effect adopting as its own, the opinion of the Tax Court is in conflict with the decisions of this court on family partnership cases (Lusthaus *v.* Commissioner, 327 U. S. 293; Commissioner *v.* Tower, 327 U. S. 280; Commissioner *v.* Culbertson, U. S. , 93 L. Ed. 1331). The Tax Court in this case, as in the Culbertson case, applied the tests of "original capital" and "vital services" as the exclusive criteria. In its opinion, the Tax Court made no mention of, and gave no consideration to, the question of whether or not the parties had a bona fide intent to create a partnership.

2. The decision of the Circuit Court, and denial of petitioners' request for a rehearing, are in conflict with the decisions of other circuit courts. Hartz *v.* Commissioner, 170 F (2) 313 (C. A. 8); Walsh *v.* Commissioner, 170 F (2) 535 (C. A. 8); Kent *v.* Commissioner, 170 F (2) 131 (C. A. 6); Lawton *v.* Commissioner, 164 F (2) 380 (C. A. 6); LeSage *v.* Commissioner, 173 F (2) 826 (C. A. 5); Culbertson *v.* Commissioner, 168 F (2) 979 (C. A. 5). Since the Culbertson decision by this Court, circuit courts, in dealing with similar family partnership cases decided by the Tax Court before the Culbertson decision, have remanded such cases to the Tax Court for further proceedings in conformity with the Culbertson decision: (Seabrook *v.* Commissioner, 176 F (2) 605 (C. A. 5); Harris *v.* Commissioner, 175 F (2) 444 (C. A. 9); Trepte *v.* Commissioner, 175 F (2) 444 (C. A. 9)); or have themselves applied the principles clarified in the Culbertson decision. Wenig *v.* Commissioner F (2) (CADC, July 18, 1949), §72,540 P-H Fed. 1949. See also Ginsburg *v.* Arnold, reversed and remanded on rehearing, F (2) , C. A. 5, September 13, 1949); § 72,591 P-H Fed. 1949.

WHEREFORE, your petitioners, by their attorney, Harry Shapiro, Esquire, respectfully pray that a writ of certiorari issue to review the judgment of the Court of Appeals for the Third Circuit affirming the judgment of the Tax Court.

Harry Shapiro

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI

Opinions Below.

The memorandum opinion of the Tax Court (R. 13, 14) may be found at § 48,181—1948 P-H T. C. Memo. The opinion of the Court of Appeals (R. 72), Eisenberg *v.* Commissioner, is reported in 174 F (2) 827 (C. A. 3).

Jurisdiction.

The jurisdiction of this court is invoked under 28 U. S. C. 1254.

Statement of the Case.

The statement of the case appears in the Petition at pages 2 to 5 inclusive, and is omitted here in the interest of brevity.

Specifications of Errors.

The Court of Appeals erred:

1. In affirming the decision of the Tax Court.

2. In refusing to grant a rehearing after entry of the decision by this Court in Commissioner *v.* Culbertson.

3. In holding that the children's partnership interests were not recognizable for federal tax purposes.

4. In failing to determine that petitioners are not taxable on the income of the children's trusts as grantors thereof, under the doctrine of Helvering *v.* Clifford.

5. In upholding the Tax Court's finding that there were no completed gifts to the children.

Argument.

It is evident from Culbertson that the Tax Court had consistently applied an erroneous concept of the Lusthaus and Tower cases in their consideration of family partnership cases. The Culbertson opinion has without question

revised that concept. It is now urged that as a general proposition tax cases decided against a taxpayer under the old erroneous concepts should be remanded for consideration under the corrected concepts.

In reversing and remanding the Culbertson case to the Tax Court, this Court stressed the misplaced emphasis,—the erroneous standards—applied by the Tax Court. In the instant case the same false emphasis underlies the decision of the Tax Court. (The Circuit Court affirmed without discussion "Upon the findings of the Tax Court, which we cannot say are clearly erroneous, and for the reasons stated in the opinion filed by Judge Opper for that Court * * *" (R. 72).)

Here, as in Culbertson, the Tax Court reasoned that "Absent both capital originating with them and the contribution of services, * * * the alleged partnership with the children is not recognizable for Federal tax purposes" (R. 14). At the time of this decision the Tax Court was still laboring under the twin misapprehensions, exposed as such by Culbertson:—that the Lusthaus and Tower cases devised a special concept of partnership for Federal tax purposes,—and that no partnership was valid for such purposes in the absence of "original capital" or "vital services". Again, as in Culbertson, the Tax Court did not discuss the bona fides of the parties nor "once in its opinion is there even an oblique reference to any lack of intent * * *."

Had the inquiry been made as to the intent of the parties there would be but one conclusion,—that the formation of this partnership was brought about by compelling business considerations. Hartz *v.* Commissioner, *supra;* LeSage *v.* Commissioner, *supra;* O. H. Delchamps, 13 T. C. #39, Decided August 30, 1949. The circumstances of the business were such that partnership was the only means available to petitioners for satisfying their obligations to their children, *i. e.,* the obligation which arose upon the use of the children's money to start the partnership business. The business was without sufficient

cash to discharge this obligation. Any attempt to recognize this obligation by setting the children up as creditors, would have seriously impaired its credit rating and seriously endangered its financial stability. The Tax Court's conclusion that this was the fathers' money is "not within the realm of legitimate inference from the record as a whole or from the specific facts found." Wenig *v.* Commissioner, *supra,* p. 72,885 P-H Fed. 1949. That conclusion stems from the erroneous concept of "original capital" which was fashionable with the Tax Court prior to the Culbertson decision. The Tax Court no longer follows such a concept. Edw. A. Theurkauf, 13 T. C. #70, Decided October 7, 1949; O. H. Delchamps, *supra.*

If the Tax Court's inquiry in this case had been directed to the source of the business earnings, petitioners must nevertheless prevail. The evidence is undisputed that capital was the major income producing factor in the petitioners' business (R. 21-42) and that petitioners were adequately compensated for their services before distribution of profits (R. 42).

Prior to the Culbertson decision other circuits were already in conflict with the action of the Third Circuit herein. Eighth: Hartz *v.* Commissioner, *supra;* Walsh *v.* Commissioner, *supra.* Sixth: Kent *v.* Commissioner, *supra;* Lawton *v.* Commissioner, *supra.* Fifth: LeSage *v.* Commissioner, *supra;* Culbertson *v.* Commissioner, *supra.*

In the instant case the Circuit Court refused a petition for rehearing sought on the basis of the conflict of the Tax Court's opinion herein with this Court's opinion in the Culbertson case.

Since the Culbertson decision, both the Fifth and the Ninth Circuits have reversed decisions against taxpayers in similar cases, and remanded the cases to the lower courts for further proceedings in conformity with the views expressed in the Culbertson decision. Ninth: Harris *v.* Commissioner, *supra,* and Trepte *v.* Commissioner,

supra. Fifth: Seabrook *v.* Commissioner, *supra,* and Ginsburg *v.* Arnold, *supra.*

The effect on the Tax Court of this Court's decision in the Culbertson case is evident from its recent decisions. By analogy it would seem that petitioners would have obtained a favorable result if the Tax Court had had the Culbertson decision to guide it. Edw. A. Theurkauf, *supra;* O. H. Delchamps, *supra;* Fred C. Campbell, §49,198 P-H T. C. Memo, Decided August 25, 1949; Est. of Frederick A. Depue, 13 T. C. #62, Decided September 30, 1949. A number of the circuits are apparently willing to give the Tax Court and other lower courts an opportunity to conform to Culbertson in cases in which decisions were entered by the lower court before it had the benefit of the Supreme Court's latest word on the subject. The position of taxpayers with similar cases pending before other circuits merits the further attention of this Court. For those taxpayers whose cases have already reached final judgment against them, there can be no assistance from the courts. This is purely a legislative problem. But for those against whom no final judgment has been entered, whose cases were considered by lower courts searching only for "original capital" and "vital services", judicial relief can and should be made available.

Conclusion.

It is, therefore, respectfully submitted that for the foregoing reasons your Honorable Court should grant the Petition for Writs of Certiorari.

Respectfully submitted,

Harry Shapiro

Attorney for Petitioners.

Hirsh W. Stalberg,
David V. Shapiro,

Shapiro, Conner, Rosenfeld & Stalberg,
Of Counsel.